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Financial Markets

Irving Trust

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This week, market rates declined sharply on Wednesday in reaction to the Federal Reserve's execution of customer RPs when funds were trading at 8 3/4%. Later in the week, as the Fed gave no additional confirmation of ease and unexpectedly strong June housing starts were reported, rates backed up to offset some of the earlier declines. Finally, around noon today the Fed entered the market to arrange over-the-weekend customer RPs with funds trading at 8 3/4%. This confirmed that the Fed is willing to allow funds to trade lower than in recent weeks.

The minutes of the May 20 Federal Open Market Committee, released last Friday, contain a number of clues as to why the Fed seemingly has abandoned the new operating procedures announced last October 6. Most press discussions of the minutes have focused on the 8 1/2%-14% acceptable range for the weekly average funds rate that was adopted at the meeting. It should be clear from the pattern of recent weeks, however, that the Fed, in practice, has not had to use all of the leeway granted to the Open Market Desk to allow the funds rate to decline. Indeed, it is conceivable that the FOMC meeting on July 9 may have lowered the bottom of the range to 8% or 7 1/2%--but as a practical matter the additional authority (if any) is not yet being used.

From the minutes and the Fed's recent behavior, it is clear that the focus of the Fed's operating procedures has placed increased emphasis on interest rates. The reason, emphasized in the minutes (but ignored in the press), is that the Fed's staff analysis argued that the below-target growth of the money supply in recent months was an aberration. The staff made three key predictions: (1) May-June money growth would be strong; (2) the strong growth would still not suffice to get money back to the bottom of the target range by the end of June; and (3) in a few months, money would return to its target range, even if no additional reserves stimulus were provided. The first two of these predictions were right on the mark; insufficient time has elapsed to pass on the third. As a result, going into the July 9 meeting the staff had no reason to change its outlook, and the FOMC certainly had no reason to dispute it. Naturally, worries about inflation and the foreign exchange value of the dollar also pointed to an operational focus on interest rates.

In the near term, the staff prediction that money will return to its target range probably will not be validated, for two principal reasons. First, the economy continues weak--though there are some signs of bottoming out--and that should dampen money demand. Second, the most rapidly growing form of checkable account --shares of money market mutual funds--is not even included in M1B. As depositors continue to shift balances to money funds, the measured money stock will tend to be sluggish. To spur money growth, the Fed will be forced to increase its provision of reserves, thus lowering interest rates. (Though M1A and M1B are below their targets, M2, which includes money fund shares, is right in the middle of the target range, due in large part to recent strong money fund growth.)

Hence the outlook is for an additional easing of the Fed's policy stance before long, perhaps around the scheduled August 19 FOMC meeting.

William C. Melton

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Market Yields

	7/18/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(noon)		
Short-term loans to substantial depositors with highest credit rating	11.50%	11.50%	11.50%
Effective since	7/7/80		
Discount Rate at Federal Reserve Bank	11.00	11.00	10.00
Federal Funds	8.75	9.13	10.63
Repurchase Agreements	8.13	8.25	9.60
U.S. Treasury Issues			
Bills			
3 months	7.90	8.25	9.80
6 months	7.90	8.50	10.05
1 year	7.83	8.60	9.85
Coupons			
2 years	8.95	9.00	9.25
4 years	9.22	9.35	8.92
7 years	9.65	9.60	8.86
10 years	10.12	10.20	8.99
Long Bond	10.12	10.25	8.95
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.65	8.65	10.20
3 months	8.65	8.75	10.30
6 months	8.70	8.85	10.55
1 year	9.00	9.50	10.25
Banker's Acceptances			
1 month	8.60	8.50	10.13
3 months	8.55	8.70	10.30
6 months	8.65	8.80	10.58
Eurodollar Deposits			
1 month	9.00	9.13	10.75
2 months	9.13	9.25	10.94
3 months	9.25	9.38	11.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	6.00	6.00	9.63
1 month	8.38	8.38	9.50
3 months	8.38	8.38	9.63
Bank Holding Companies			
1 month	8.50	8.50	9.90
Dealer Placed:			
3 months	8.38	8.13	9.95
New AA Corporate Utility Bond	11.75	12.00	9.75
Tax Exempt			
6 month Project Notes	4.70	4.80	4.60
1 year AAA Bond	5.00	5.25	N/A
5 year AAA Bond	5.30	5.45	N/A
20 year AAA Bond	7.40	7.10	5.85

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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